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1 RON BENDER (SBN 143364)
2 TODD M. ARNOLD (SBN 221868)
3 LEVENE, NEALE, BENDER, YOO & BRILL L.L.P.
4 10250 Constellation Boulevard, Suite 1700
5 Los Angeles, California 90067
6 Telephone: (310) 229-1234
7 Facsimile: (310) 229-1244
8 Email: rb@lnbyb.com; tma@lnbyb.com

9 Attorneys for Chapter 11 Debtors and Debtors in Possession

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**UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF CALIFORNIA
(SACRAMENTO DIVISION)**

In re:

MATTERHORN GROUP, INC.,

Debtor.

VITAFREEZE FROZEN CONFECTIONS,
INC.,

Debtor.

DELUXE ICE CREAM COMPANY,

Debtor.

Affects ALL DEBTORS
 Affects only MATTERHORN GROUP, INC.
 Affects only VITAFREEZE FROZEN
CONFECTIONS, INC.
 Affects only DELUXE ICE CREAM COMPANY

Lead Case No. 10-39672 (MSM)
Jointly Administered with Case Nos. 10-39664
(MSM), and 10-39670 (MSM)

DC No. LNB-12

Chapter 11 Cases

**MEMORANDUM OF POINTS AND
AUTHORITIES IN SUPPORT OF THE
DEBTORS' MOTION FOR AN ORDER
AUTHORIZING THE DEBTORS'
CONTINUED USE OF CASH
COLLATERAL**

Hearing:

Date: October 4, 2010
Time: 1:30 p.m.
Place: Department A
Judge Michael S. McManus
Courtroom No. 28, Floor No. 7
Robert T. Matsui Courthouse
501 I Street
Sacramento, CA 95814

Matterhorn Group, Inc. (“MGI”), Vitafreeze Frozen Confections, Inc. (“Vitafreeze”), and Deluxe Ice Cream Company (“Deluxe”), the debtors and debtors in possession in the above-captioned, jointly administered Chapter 11 bankruptcy cases (collectively, the “Debtors”), hereby file their Memorandum of Points and Authorities in support of their motion (the “Motion”) for an order, in substantially the form of the order on the Motion (the “Interim Order”) filed as Exhibit “2” concurrently herewith, authorizing the Debtors’ continued use of cash collateral.

MEMORANDUM OF POINTS AND AUTHORITIES

I.

STATEMENT OF FACTS

A. BACKGROUND.

On July 26, 2010 (the “Petition Date”), the Debtors each filed voluntary petitions under Chapter 11 of 11 U.S.C. §§ 101 et seq. (the “Bankruptcy Code”). The Debtors continue to operate their business, manage their financial affairs, and operate their bankruptcy estates as debtors in possession pursuant to Sections 1107 and 1108 of the Bankruptcy Code. The Debtors’ Chapter 11 cases are being jointly administered pursuant to a prior order of the Court.

MGI was formed in 2004 as a vehicle to “roll-up” frozen novelty manufacturing companies in the Western United States. The initial step in this strategy was MGI’s acquisition of Vitafreze, Deluxe, and Matterhorn Ice Cream Company (“Matterhorn”),¹ each of which became wholly owned subsidiaries of MGI. As a result of these acquisitions, by 2005, the Debtors had (1) established themselves as high-quality, high-service private label manufacturers with a strong Western United States customer base, and (2) become one of the dominant producers of ice cream novelties in the Western United States.

¹ Matterhorn is also a wholly owned subsidiary of MGI. Matterhorn is not operating and has not filed a bankruptcy case.

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1 In 2006, in an effort to improve operations and profitability, MGI (1) closed Matterhorn's
2 manufacturing plant in Caldwell, Idaho and consolidated its manufacturing into Vitafreeze, located
3 in Sacramento, California, and Deluxe, located in Salem, Oregon, and (2) took aggressive steps to
4 restructure its remaining operations to reduce overhead and reposition MGI with its customers
5 and suppliers. The Debtors' administrative office is located in Las Vegas, Nevada.
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7 At present, the Debtors, which have approximately 31 non-union employees and 226
8 union employees, are collectively one of the largest independent producers of ice cream and
9 water-ice novelty products in the United States. The Debtors manufacture (1) self-branded
10 products for grocery retailers, (2) products from brand licenses held by the Debtors, such as Mike
11 and Ike™, HotTamales™, Zours™, and Crystal Light™ popsicles, (3) co-branded products, and
12 (4) the Debtors' own products, including the Debtor's Oh My! Goodness™ branded products.
13 The Debtors' customers include the largest big-box grocery retailers, club stores, and independent
14 cooperative distribution companies in the United States, such as Wal*Mart, Sam's Club, Giant
15 Eagle, Kroger, Stater Brothers, Albertsons, Winco Foods, Raley's, Save Mart Supermarkets,
16 Safeway, Smart & Final, the Schwan Food Company, and Western Family. The Debtors also sell
17 to various retailers in Mexico.
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19 **B. THE DEBTORS' SECURED DEBT.**

20 The Debtors' primary secured creditor is Key Bank, N.A. (the "Bank"). As of the Petition
21 Date, pursuant to that certain Amended and Restated Revolving Credit and Term Loan
22 Agreement (as amended) (the "Loan Documents"), the Debtors owed the Bank approximately
23 \$1,249,983 on a term loan (the "Term Loan") and approximately \$9,314,953 on a revolving line
24 of credit (the "Line" and together with the Term Loan, the "Bank Loans") for a total of
25 approximately \$10,564,936. The Bank contends that the Bank Loans are secured by first priority
26 liens on substantially all of the Debtors' assets, including the Debtors' cash collateral (the "Cash
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1 Collateral”), although it appears to the Debtors that the Bank does not have a perfected lien
2 against the assets of MGI, which raises a number of potential preference and fraudulent
3 conveyance issues for the Bank. The Bank Loans mature on July 1, 2011.

4 In addition to the Bank, Pacific Mezzanine Fund L.P. (“PMF”) and CC&B Holdings, Inc.
5 (“CC&B”) appear to have liens on some or all of the Debtors’ assets, including the Debtors’ cash
6 collateral, securing a bridge loan in the amount of \$750,000 (\$500,000 from CC&B and \$250,000
7 from PMF). PMF owns approximately 53% of MGI’s common stock. Nathan W. Bell, a
8 Managing Member of PMF, is the current Chairman of the Debtors’ Board of Directors, and the
9 Debtors’ President. CC&B owns approximately 15% of MGI’s common stock. A principal of
10 CC&B (Michael Newell) is also a member of the Debtors’ Board of Directors. PMF and CC&B
11 made this loan to the Debtors shortly prior to the Petition Date to assist the Debtors with their
12 cash flow needs and to assist the Debtors to pay down their debt to the Bank. The Debtors
13 understand that both PMF and CC&B are very supportive of the Debtors.
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16 C. **THE NECESSITY FOR FILING BANKRUPTCY.**

17 During the period of 2007 through 2009, the Debtors gross revenues increased
18 substantially from approximately \$42,564,029 in 2007, to approximately \$47,986,399 in 2008, to
19 approximately \$54,436,328 in 2009. Unfortunately, due to expansion into new product
20 categories, increased costs related thereto, a delayed selling season due to unusually cool
21 temperatures in the Debtors geographical market and the continued need to make capital
22 expenditures to maintain the Debtors’ manufacturing facilities, these increases in gross revenue
23 did not result in corresponding increases in net income and liquidity. Instead, based on the
24 foregoing and seasonal fluctuations in the Debtors’ business and borrowing limits under the Loan
25 Documents, the Debtors found themselves in a cash crunch and were unable to meet their funding
26 needs solely from advances made by the Bank. In consideration of the Debtors’ ongoing cash
27 needs
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1 crunch and the need for breathing room to formulate and implement a restructuring plan or a sale,
2 the Debtors came to the conclusion that filing for bankruptcy protection was in the best interests
3 of the Debtors and their creditors.

4 **D. PRIOR CASH COLLATERAL USE AND THE PURPOSE FOR THIS MOTION.**

5 Since the Petition Date, the Debtors have been using cash collateral in accordance with
6 orders which have been approved by the Court. The current cash collateral order expires on
7 October 8, 2010. In an effort to resolve their disputes, the Debtors and the Bank are engaged in
8 active discussions with the goal to agree upon (i) the terms of a process that is designed to result
9 in the consummation of a sale of substantially all of the Debtors' assets excluding cash on hand
10 and causes of action under Chapter 5 of the Bankruptcy Code ("Avoidance Causes of Action") in
11 the most expeditious manner possible for the most money possible under the circumstances, and
12 (ii) an allocation of the proceeds obtained from any such asset sale, cash on hand and proceeds
13 from other assets not included in such asset sale including Avoidance Causes of Action. The
14 Debtors are hopeful that such an agreement will be finalized and signed prior to the next
15 continued cash collateral hearing, which is scheduled to be held on October 4, 2010 at 1:30 p.m.
16 The Debtors are therefore filing the Motion referenced herein to make sure the Debtors have
17 continued use of cash collateral beyond October 8, 2010.

18 Filed concurrently herewith as Exhibit "1" is the Debtors' proposed operating budget
19 through October 22, 2010 (the "Budget"). By the time of the filing of the Motion, the Debtors
20 had not yet provided the Bank with a copy of the Budget as the budget was only finalized on the
21 day of the filing of this Motion. Given the status of the global settlement discussions between the
22 Debtors and the Bank, the Debtors are operating under the assumption that the Bank will be
23 supportive of the Debtors' continued use of cash collateral in accordance with the terms of this
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1 Motion. If this proves not to be the case, the Debtors will file further supplemental pleadings with
2 the Court in support of this Motion.

3 **E. THE DEBTORS' PROPOSED OPERATING BUDGET AND THE DEBTORS'**
4 **CURRENT AND PROJECTED ASSET BASE.**

5 Filed concurrently herewith as Exhibit "1" is the Debtors' proposed operating budget
6 through October 22, 2010 (the "Budget"), which includes a description of the Debtors' projected
7 collateral base.

8 The Debtors submit that the Court should authorize the Debtors to continue using cash
9 collateral through October 22, 2010 under the same terms and conditions as the Court has
10 already approved three times, which includes the making of adequate protection payments to the
11 Bank in the amount of \$72,531 per month. The Debtors believe that doing so is in the best
12 interests of their estates and their creditors, including the Bank, because the alternative to the
13 Debtors' continued use of cash collateral is a complete shut down of the Debtors' business which
14 would result in the loss of the jobs of all of the Debtors' employees and the decimation of the
15 Debtors' going concern value. The Debtors assume that the Bank will be supportive of the
16 Debtors' Motion but there has not been sufficient time for the parties to discuss the Budget by
17 the time of the filing of the Motion.

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21 II.

22 **DISCUSSION**

23 **A. THE DEBTORS MUST BE AUTHORIZED TO USE CASH COLLATERAL TO**
24 **OPERATE, MAINTAIN, AND PRESERVE THEIR BUSINESS IN ACCORDANCE**
25 **WITH THE BUDGET.**

26 The Debtors' use of property of their estates is governed by Section 363 of the Bankruptcy
27 Code. Section 363(c)(l) provides in pertinent part:

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1 If the business of the debtor is authorized to be operated under
2 section . . .1108. . . of this title and unless the court orders
3 otherwise, the trustee may enter into transactions, including the
4 sale or lease of property of the estate, in the ordinary course of
5 business, without notice or a hearing, and may use property of the
6 estate in the ordinary course of business without notice or a
7 hearing.

8 11 U.S.C. §363(c)(1). A debtor in possession has all of the rights and powers of a trustee with
9 respect to property of the estate, including the right to use property of the estate in compliance
10 with Section 363. See 11 U.S.C. §1107(a).

11 “Cash collateral” is defined as “cash, negotiable instruments, documents of title,
12 securities, deposit accounts or other cash equivalents in which the estate and an entity other than
13 the estate have an interest. . . .” 11 U.S.C. §363(a). Section 363(c)(2) allows the use of “cash
14 collateral” under subsection (c)(1) if:

15 (A) each entity that has an interest in such cash collateral
16 consents; or
17 (B) the court, after notice and a hearing, authorizes such use,
18 sale or lease in accordance with the provisions of this section.

19 See 11 U. S.C. §363(c)(2)(A) and (B).

20 It is well settled that it is appropriate for a Chapter 11 debtor to use cash collateral for the
21 purpose of maintaining and operating its property. 11 U.S.C. § 363(c)(2)(B); In re Oak Glen R-
22 Vee, 8 B.R. 213, 216 (Bankr. C.D. Cal. 1981); In re Tucson Industrial Partners, 129 B.R. 614
23 (B.A.P. 9th Cir. 1991). In addition, where the debtor is operating a business, it is extremely
24 important that the access to cash collateral be allowed in order to facilitate the goal of
25 reorganization: “the purpose of Chapter 11 is to rehabilitate debtors and generally access to cash
26 collateral is necessary to operate a business.” In re Dynaco Corporation, 162 B.R. 389 (Bankr.
27 D.N.H. 1993), quoting In re Stein, 19 B.R. 458, 459 (Bankr. E.D. Pa. 1982).

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1 The only source of revenue available to the Debtors to use to operate, maintain and
2 preserve their business is the Debtors' cash from their business operations. As a result, the
3 Debtors have no ability to continue to operate their businesses and maintain and preserve the
4 going concern value of their business unless the Debtors have continued access to and use of their
5 Cash Collateral to pay the Debtors' ordinary operating expenses as set forth in the Budget. The
6 Debtors inability to pay those expenses, including basic and critical operating expenses such as
7 payroll, rent and product supply purchases, would result in the immediate closure of the Debtors'
8 manufacturing facilities resulting in the termination of approximately 255 jobs and the decimation
9 of the overall going concern value of the Debtors' business.

10 Consistent with the three prior cash collateral orders which were entered by the Court, in
11 addition to those expenses set forth in the Budget, the Debtors also seek authority to use Cash
12 Collateral to pay for the following: (a) all quarterly fees owing to the Office of the United States
13 Trustee and all expenses owing to the Clerk of the Bankruptcy Court; and (b) all actual third-party,
14 outside expenses incurred by the Debtors (or their counsel) directly related to the administration of
15 the Debtors' bankruptcy estates (for items such as photocopying, postage, searches, etc.), not to
16 exceed the total sum of \$10,000 per month. In addition, the Debtors seek authority to deviate from
17 the line items contained in the Budget by not more than 15% on a line item basis and not more than
18 10% on an aggregate basis. Moreover, if actual expenditures for any line items during a particular
19 period are less than in the Budget, the difference shall carryover to the following period covered by
20 the Budget. To the extent the Debtors' order volume exceeds the Debtors' projected order volume,
21 the Debtors seek authority to increase the amount of their related variable cost operating expenses
22 on a proportional basis. The Debtors also seek to have the authority to pay any other expenses
23 related to the operation of the Debtors' business which are not contained in the Budget without the
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1 need for any further order of the Court provided the Bank and the Creditors' Committee consent to
2 those payments in advance and in writing.

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4 **B. THE BANK IS ADEQUATELY PROTECTED BY AN EQUITY CUSHION,**

5 **CONTINUED ADEQUATE PROTECTION PAYMENTS, REPLACEMENT**

6 **LIENS, AND THE DEBTORS' CONTINUED OPERATION OF THEIR**

7 **BUSINESS.**

8 To the extent that an entity has a valid security interest in the revenues generated by
9 property, those revenues constitute "cash collateral" under Section 363(a) of the Bankruptcy
10 Code. Pursuant to Section 363(c)(2), the Court may authorize the debtor to use a secured
11 creditor's cash collateral if the secured creditor is adequately protected. In re Mellor, 734 F.2d
12 1396, 1400 (9th Cir. 1984); see also In re O'Connor, 808 F.2d 1393, 1398 (10th Cir. 1987); In re
13 McCombs Properties VI, Ltd., 88 B.R. 261, 265 (Bankr. C.D. Cal. 1988).

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15 Pursuant to the Supreme Court case of United Savings Association v. Timbers of Inwood
16 Forest Associates, 108 S.Ct. 626, 629 (1988) and subsequent case law, the property interest that a
17 debtor must adequately protect pursuant to Sections 361(1) and (2) of the Bankruptcy Code is
18 only the value of the lien that secures the creditor's claim. Timbers, 108 S.Ct. at 630; see also
19 McCombs, at 266. Section 506(a) "limit[s] the secured status of a creditor (*i.e.*, the secured
20 creditor's claim) to the lesser of the [allowed amount of the] claim or the value of the collateral."
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22 McCombs, 88 B.R. at 266.

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24 The Ninth Circuit made clear in Mellor that in the case of an oversecured creditor, an
25 equity cushion of 20% is considered clear adequate protection of a secured creditor's interest in
26 cash collateral. Mellor, 734 F.2d at 1401; see also In re McGowan, 6 B.R. 241, 243 (Bankr. E.D.
27 Pa. 1980) [holding a 10% cushion is sufficient to be adequate protection]; In re Rogers
28 Development Corp., 2 B.R. 679, 685 (Bankr. E.D. Virg. 1980) [court decided that an equity

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1 cushion of approximately 15% to 20% was sufficient adequate protection to the creditor, even
2 though the debtors had no equity in the property.]

3 As set forth above, the total amount allegedly owed by the Debtors to the Bank is
4 approximately \$10,564,936. As set forth in the Budget, the Debtors' total collateral base
5 (excluding any value for the Debtors' intellectual property or good will) is expected to be
6 \$14,990,391 by the week ending October 8, 2010; is expected to be \$14,355,931 by the week
7 ending October 15, 2010; and is expected to be \$14,322,920 by the week ending October 22,
8 2010. The Bank therefore continues to be secured by a substantial equity cushion, which is well in
9 excess of the de facto 20% equity cushion, which constitutes clear adequate protection as a matter
10 of law under Mellor.

12 Despite the fact that the Bank is adequately protected by a substantial equity cushion, the
13 Debtors nevertheless intend to continue to make monthly adequate protection payments to the
14 Bank as the Debtors have done thus far in the amount of \$72,531.

16 As additional adequate protection for the Bank and any other creditor with an interest in
17 the Debtors' Cash Collateral, the Debtors seek to provide them with a replacement lien and
18 507(b) claims in the same manner as the prior cash collateral orders which have been approved by
19 the Bank and entered by the Court.

20 Additionally, the law is also clear that the preservation of the value of a secured creditor's
21 lien is sufficient to provide adequate protection to a secured creditor when a debtor seeks to use
22 cash collateral. In re Triplett, 87 B.R. 25 (Bankr. W.D.Tex. 1988); see also In re Stein, 19 B.R.
23 458 (Bankr. E.D. Pa. 1982). In determining adequate protection, Courts have stressed the
24 importance of promoting a debtor's reorganization. In O'Connor, the Tenth Circuit stated:
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27 In this case, Debtors, in the midst of a Chapter 11 proceeding, have
28 proposed to deal with cash collateral for the purpose of enhancing

1 the prospects of reorganization. This quest is the ultimate goal of
2 Chapter 11. Hence, the Debtor's efforts are not only to be
3 encouraged, but also their efforts during the administration of the
4 proceeding are to be measured in light of that quest. Because the
5 ultimate benefit to be achieved by a successful reorganization
6 inures to all the creditors of the estate, a fair opportunity must be
7 given to the Debtors to achieve that end. Thus, while interests of
8 the secured creditor whose property rights are of concern to the
9 court, the interests of all other creditors also have bearing upon the
10 question of whether use of cash collateral shall be permitted during
11 the early stages of administration.

12 O'Connor 808 F.2d at 1937.

13 Here, there can be no question that the only way for Debtors to preserve the going concern
14 value of their business, as well as the Bank's collateral, and to avoid an immediate shut down of
15 the Debtors' business, is for the Debtors to have the authority to continue to use Cash Collateral
16 to pay the expenses contained in the Budget. Any other alternative is nonsensical and serves only
17 to the severe detriment to all of the Debtors' creditors (including the Bank) and all other parties in
18 interest in these cases. Thus, there is no doubt that the Debtors' continued use of Cash Collateral
19 to fund operations will serve to provide yet another means of adequate protection for the Bank
20 and any other creditors with an interest in the Debtors' Cash Collateral.

21 With the foregoing package of adequate protection measures, the Debtors submit that the
22 Bank and any creditors with an interest in the Debtors' Cash Collateral are all adequately
23 protected. Therefore, good cause exists for granting the relief requested in the Motion.

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III.2
CONCLUSION3
WHEREFORE, the Debtors respectfully request that the Court enter an order in
4 substantially the form filed as Exhibit "2" concurrently herewith and grant such other and further
5 relief as the Court deems just and proper under the circumstances of these cases.
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7 Date: September 27, 2010

LEVENE, NEALE, BENDER, YOO
8 & BRILL L.L.P.9 */s/ Ron Bender* _____

10 RON BENDER

11 TODD M. ARNOLD

12 Attorneys for Chapter 11 Debtors
13 and Debtors in Possession

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